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SUBJECT: IMPACT OF RISING PHILIPPINE FOOD PRICES

REF: A) SECSTATE 39410, B) MANILA 00838

11. Summary: Rising international food prices will hurt the Philippine economy and most Filipinos because of widespread poverty and dependence on grain imports. The Philippine government's intervention to make rice available for low-income families at subsidized prices has prevented major public protests or violence. Philippine President Gloria Macapagal Arroyo has committed P43.7 (\$1.05 B) billion in support of a package of programs to guarantee stable supply and prices in rice and other food crops. Growing food subsidies will challenge efforts to balance the government budget. We believe Washington should consider providing some funding for the International Rice Research Institute, an excellent institution which the USG has supported strongly in the past. End summary.

#### Philippine Demand for Grain

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12. The Philippines is a net importer of rice, corn and wheat. Rice sold by the state-controlled National Food Authority has remained at a subsidized rate of P18.25 per kilo (about \$0.43 at the current exchange rate of P41.7:\$1) while commercial rice has risen to around twice the subsidized price. Corn grits, priced at P16 per kilo in December 2007, currently sell at P30 per kilo. The price of wheat flour per 25-kilo bag has gone up from P840 in January to P990 in April. Bread, meat, fish, poultry, and vegetables have all increased in price this year. Domestic production of rice equals 90 percent of consumption, and domestic corn production equals 80 percent of consumption, while wheat is 100 percent imported.

#### Living on the Edge

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13. The food consumption habits of the 40 percent of Filipinos who survive on less than two dollars per day are very price sensitive. Consumption of (subsidized) rice increases as prices of other foods go up. Food expenditures take 60-70 percent of the income of the poorest 30 percent of Filipino families. Surging food prices will worsen the country's already high poverty rate. Recently released government poverty statistics indicate that the ratio of poor Filipinos not able to afford basic food and non-food needs increased from 30 percent in 2003 to 33 percent in 2006, or about 28 million Filipinos who did not have adequate income to meet basic needs in 12006. About 45 percent of these poor Filipinos subsisted below government-established food-poverty thresholds. The Philippines has large income disparities between regions: the National Capital Region has a 10.4 percent poverty rate, while Muslim Mindanao has a 62 percent poverty rate. It is worth noting, however, that the bulk of the poor in the Philippines live in rural areas, many earning their livings from agriculture. The increase in agricultural prices is benefiting many of them.

¶4. Food accounts for 47 percent of the Philippines consumer price basket. Grains comprise nearly 30 percent of overall food expenditures in the basket, followed by meat and poultry at 16 percent. Rice alone makes up 20-25 percent of the food basket. Year-on-year consumer price inflation has been accelerating, led by food. Inflation averaged 5.6 percent during the first quarter of ¶2008. Food price inflation accelerated to 8.4% in March 2008, with average (subsidized and non-subsidized) rice prices up 11 percent, corn by 8.4 percent, cereal preparations by 11.3 percent, and meat/poultry up by 7 percent. Current plans are for the Philippines to import 2.1 million metric tons of rice during 2008 (up from 1.8 million metric tons purchased in 2007). The total import bill for rice in 2008 could jump to about \$1.7 billion - up from \$600 million in 2007. However, the government expresses confidence that the balance of payments will end 2008 in surplus since international reserves and overseas workers remittances both reached news high in March 2008.

Where will it come from?

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¶5. Currently, Philippine rice cultivation covers 2.3 million hectares of land. This year the country aims to increase domestic production of un-milled rice to a record 17.32 million tons, up seven percent from last year (16.24 million tons), but the National Food Administration will still need to import well over two million tons of rice to meet demand. Corn production has also been increasing due to the rise in corn prices. Studies indicate that after a good harvest in 2007, rural household stocks of rice increased. Rice farmers store 20 to 40 percent of their harvest at home. Due to increasing prices, rural households have been selling

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more rice to commercial traders, but less to the Food Administration, which pays less than the top commercial rates. As a result, agricultural experts estimate that current household and commercial rice stocks are high, while Food Administration stocks are low. The current national rice inventory should be sufficient for roughly 50 to 55 days, well within the normal range for this time of year.

Limits to Growth

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¶6. Budgetary constraints will limit recent policy initiatives to increase food production and agricultural investment. The government has temporarily halted conversion of lands classified as agricultural to other purposes, and hopes to increase the amount of land devoted to the rice production. Current losses during drying, storage, transport, milling, and distribution of rice and corn range from 20 to 40 percent. Waste and inefficiency characterize each link in the existing supply chain. USAID has programs in the Philippines that promote agricultural productivity and elimination of transport and supply-chain bottlenecks. U.S. agencies also support agricultural biotechnology and the use of biofuels. As requested, U.S. agencies will work with the government on a review of current grain policy and programs, particularly the operation of the National Food Authority.

¶7. Rising international rice prices are aggravating the already shaky finances of the National Food Authority, which, as of end-2007, had a negative net worth of over 50 billion pesos (\$1.2 billion) and outstanding liabilities of about 70 billion pesos (\$1.7 billion). Food Authority officials estimate that a \$1,000 per metric ton import price equals about P50 pesos per kilo, over twice the subsidized price. The Authority's debt represents contingent obligations on the part of the National Government and poses a growing threat to the longer-term stability of public sector finances.

Political Impact

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¶8. There have been no major public protests or violence associated with the rice issue thus far, only a few scattered protests involving a few people. The government's extraordinary efforts to make subsidized rice available during the month of April (described ref B) ensured that, for now, low-income families have rice at affordable prices. However, there is still the possibility that people will take to the streets if food prices continue to rise. The situation has given traction to labor groups that seek wage hikes. There could be food-related demonstrations during the May 1 Labor Day holiday. The food price increases have served as a wake-up call for the Arroyo administration to reassess its overall agricultural policies and programs. President Arroyo is responding to concerns about the impact of higher food prices in part by supporting a legislative proposal to exempt minimum wage earners from income tax.

¶9. Over the longer term, rising food prices may add to pressure on the country's natural resources. Much depends on policy choices regarding land use patterns. The rice issue has sparked public debate about whether to suspend implementation of the recently passed Biofuels Act. A senior Philippine Senator has charged that biofuel production threatens the availability of food. However, others argue that biofuels are not a factor in recent food price increases.

¶10. Philippine legislators resumed sessions April 21 with pledges to help solve the rice/food issue. Proposals include funds for upgrading and repair of irrigation systems, financial assistance for farm inputs, and re-aligning roles for the Philippine National Food Authority. President Arroyo committed to allot P43.7 (\$1.05 B) billion for an agricultural package aimed at providing the country with a stable food supply. The President also announced her intention to fund hybrid rice seed subsidies to farmers, increased irrigation and higher Food Authority buying prices for un-milled rice.

#### The International Rice Research Institute

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¶11. The USG has supported the International Rice Research Institute (IRRI), an excellent organization which has made a huge contribution to rice production worldwide, to the tune of more than \$200 million since 1970. A tight budget led to elimination of the small remaining funding for IRRI this year. Post believes that, if funding could be found, providing some resources to IRRI would have tremendous public diplomacy advantages while making a real

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contribution to the long-term solution to food price issues.

Kenney